# 2015 HALF-YEAR FINANCIAL REPORT

paragon

The Paragon Group of Companies uses its core risk and credit expertise to develop lending products for specialist target markets. Best known as the UK's largest, independent buy-to-let lender, Paragon is growing its business by expanding further in buy-to-let lending and diversifying into new consumer lending markets through its recently established subsidiary, Paragon Bank PLC. The Group is also one of the UK's largest debt purchasers through its Idem Capital subsidiary, where it purchases, co-manages and services secured and unsecured consumer loan portfolios.

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CAUTIONARY STATEMENT

Sections of this half-yearly report, including but not limited to the Interim Management Report, may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These have been made by the directors in good faith using information available up to the date on which they approved this report. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a profit forecast.

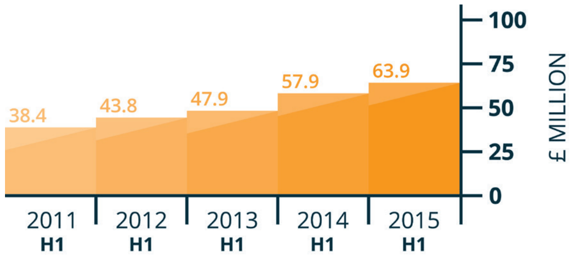
# FINANCIAL HIGHLIGHTS



## Underlying profits

£63.9million

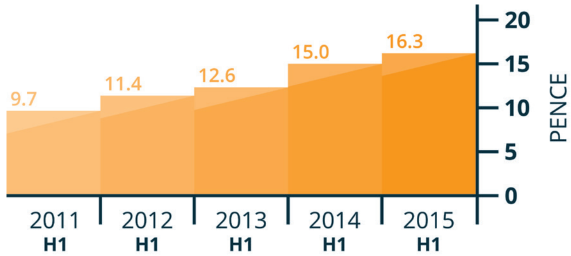
**10.4% higher, compared with £57.9 million in H1 2014**

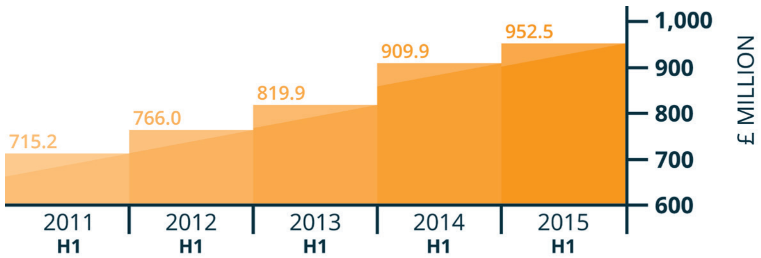



## Basic earnings per share

16.3pence

**8.7% higher, compared with 15.0 pence in H1 2014**




## Shareholders' funds

£952.5million

**4.7% higher, compared with £909.9 million at 31 March 2014**

"These results demonstrate how far Paragon has progressed in recent years as one of the UK's leading specialist lenders. Considerable growth in buy-to-let lending volumes and strong momentum into the second half of the year, complemented by the launch of a number of additional products which contribute to the on-going diversification of its income streams, have significantly enhanced the Group's franchise. Notwithstanding the start-up costs of Paragon Bank and new business strain associated with higher volume levels, the Group delivered record interim profits, up 10.4% from the same period in 2014.

The substantial increase in capacity and access to new and deeper funding markets, particularly through Paragon Bank, provides the platform to support further sustainable growth and diversification going forward. The bank has made excellent progress since its launch just over a year ago and is on track to break even during the 2016 financial year.

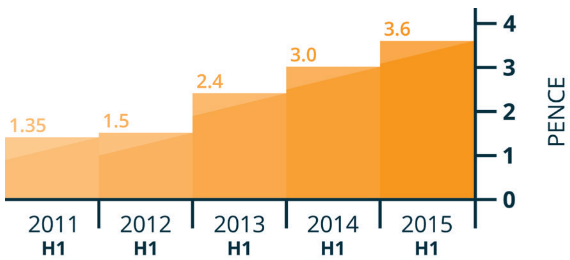
The Group remains focussed on enhancing shareholder returns. The interim dividend has grown by 20.0% and good progress has been made on the share buy-back programme. Return on equity has improved to 10.8% whilst maintaining robust and high quality capital levels to support the Group's aspiration for strong future growth."

**Nigel S Terrington**
Chief Executive

## Dividend per share

# 3.6pence

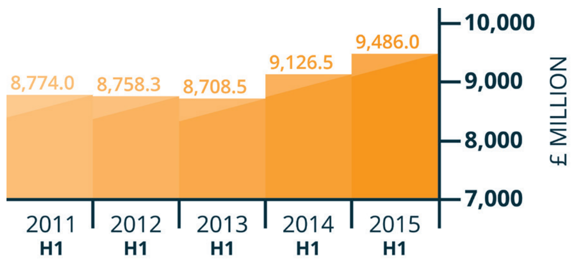
**20% higher, compared with 3.0 pence in H1 2014**




## Total investment in loans

# £9,486.0million

**3.9% higher, compared with £9,126.5 million at 31 March 2014**




## Completions and pipeline

*Completions*

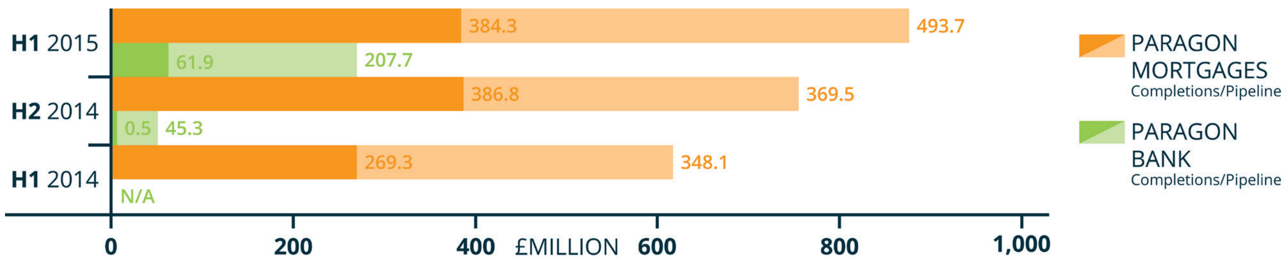
# £446.2million

**65.7% higher, compared with £269.3 million in H1 2014**

*Pipeline*

# £701.4million

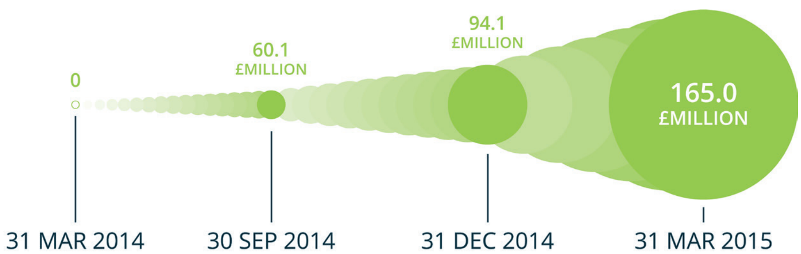
**101.5% higher, compared with £348.1 million at 31 March 2014**




## Paragon Bank retail savings deposits

# £165.0million

**Steady build up in retail savings deposits**



# HALF-YEAR FINANCIAL STATEMENTS

## INTERIM MANAGEMENT REPORT



The six months ended 31 March 2015 have seen the Group deliver improving profits in line with expectations and make further progress in developing its three business units, together with further diversification of its funding base and enhanced returns to shareholders.

Underlying profit, before movements in fair value for hedging instruments, increased by 10.4% to £63.9 million for the six months (2014 H1: £57.9 million). Profit before tax increased by 7.6% to £62.6 million (2014 H1: £58.2 million) after accounting for fair value items.

Earnings per share were 16.3p (2014 H1: 15.0p), the increase of 8.7% from the comparable period last year reflecting the improved profits earned by the Group. The increase in profit has also improved the Group's return on equity to 10.8% from 10.5% for the first half of the previous year (note 4).

Buy-to-let completion volumes grew by 65.7% in aggregate to £446.2 million, of which £61.9 million was advanced in Paragon Bank. Idem Capital invested £20.9 million in loan portfolios and Paragon Bank originated a further £19.5 million in its car finance and second mortgage operations where the focus has been on establishing distribution.

In addition to growth in Paragon Bank, where deposit levels have risen to £165.0 million, the Group's funding diversification strategy has been materially advanced by the completion of its first securitisation transaction including notes denominated in euros since the credit crisis. Warehouse capacity was also extended to £750.0 million from £550.0 million at 30 September 2014. Further, the Group has also secured a BBB- investment grade rating from Fitch Ratings to support both the scale and pricing of future corporate debt issuance.

In view of this continued progress, the Board has proposed an interim dividend of 3.6p per share, an increase of 20.0% on the 2014 interim dividend (2014 H1: 3.0p), in line with the Group's objective of achieving a dividend cover ratio of three times in 2016.

# FINANCIAL REVIEW

## CONSOLIDATED RESULTS

For the six months ended 31 March 2015

| | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 |
|---|---|---|
| | **£m** | £m |
| Interest receivable | **164.7** | 143.9 |
| Interest payable and similar charges | **(67.5)** | (56.9) |
| **Net interest income** | **97.2** | 87.0 |
| Other operating income | **6.8** | 9.4 |
| **Total operating income** | **104.0** | 96.4 |
| Operating expenses | **(36.6)** | (31.0) |
| Provisions for losses | **(3.5)** | (7.5) |
| **Underlying profit** | **63.9** | 57.9 |
| Fair value net (losses) / gains | **(1.3)** | 0.3 |
| **Operating profit being profit on ordinary activities before taxation** | **62.6** | 58.2 |
| Tax charge on profit on ordinary activities | **(12.8)** | (12.6) |
| **Profit on ordinary activities after taxation** | **49.8** | 45.6 |

| | | |
|---|---|---|
| Dividend – Rate per share for the period | **3.6p** | 3.0p |
| Basic earnings per share | **16.3p** | 15.0p |
| Diluted earnings per share | **16.0p** | 14.6p |

Total operating income increased by 7.9% to £104.0 million (2014 H1: £96.4 million). Within this, net interest income increased to £97.2 million from £87.0 million for the six months ended 31 March 2014. The increase reflects both improving margins and growth in the size of the average loan book, which rose by 4.6% to £9,362.1 million (31 March 2014: £8,953.7 million) (note 29). Annualised net interest margins increased in the six months to 31 March 2015 to 2.09% compared to the 1.96% achieved in the corresponding period last year (note 29), driven by new originations and portfolio purchases having higher margins than those assets redeeming in the period and general improvements in the financing costs of the Group's warehouse and new securitisation structures.

Other operating income was £6.8 million for the six months, compared with £9.4 million in the comparable period in 2014. The decrease reflects a lower level of third party fee income earned in Idem Capital with the focus of its operations having been on direct, rather than co-investment opportunities during 2014.

Operating expenses increased by 18.1% to £36.6 million from £31.0 million for the six months ended 31 March 2014. The operational costs of Paragon Bank, where expenditure will exceed associated revenues whilst the business becomes established, had a significant impact on Group costs in the period. This resulted in the cost:income ratio increasing to 35.2% from 32.2% for the corresponding period last year (note 7), although it remains significantly below the industry average. The underlying cost:income ratio excluding the Paragon Bank segment rose less, to 30.9% compared to 28.9% in the six months ended 31 March 2015, the non-bank increase being attributable to higher share-based payment costs, arising from the strong performance of the Group's share price and the recruitment of personnel to support the generation of new business. The Board remains focused on controlling operating costs through the application of rigorous budgeting and monitoring procedures and targets a medium term cost:income ratio below 30.0%.

The charge of £3.5 million for loan impairment has reduced by 53.3% from that for the first half of 2014 (2014 H1: £7.5 million). As an annualised percentage of average loans to customers the impairment charge has reduced to 0.07% compared to 0.16% in the six months ended 31 March 2014 (note 29). The Group has seen positive trends in arrears performance over the period, with the incidence of new cases reducing and customers correcting past arrears, whilst increasing property values have served to reduce overall exposure to losses on enforcement of security. The loan books continue to be carefully managed and the credit performance of the buy-to-let book remains exemplary.

Yield curve movements during the period resulted in hedging instrument fair value net losses of £1.3 million (2014 H1: £0.3 million net gains), which do not affect cash flow. The fair value movements of hedged assets or liabilities are expected to trend to zero over time, as such this item represents a timing difference. The Group remains economically and appropriately hedged.

Cash flows from the Group's securitisation vehicle companies and the acquired portfolios remain strong and finance, alongside debt raisings, investments in further loan portfolios and credit enhancement for mortgage originations. Cash was also utilised in the share buy-back programme, which commenced during December 2014 and where £17.2 million had been deployed by 31 March 2015. Free cash balances were £206.7 million at 31 March 2015 (31 March 2014: £169.4 million) (note 16).

Corporation tax has been charged at the rate of 20.4%, compared with 21.6% for the corresponding period last year; the reduction principally arising from the reduction in the rate of UK Corporation Tax applying to the Group in the period.

Decreasing gilt yields have increased the accounting value placed on the liabilities of the Group's defined benefit pension plan over the six months ended 31 March 2015, so despite investment return on the plan's assets being higher than expected the deficit under IAS 19 has increased to £26.0 million (31 March 2014: £12.2 million). This resulted in an actuarial loss in other comprehensive income of £8.8 million before tax (2014 H1: gain of £3.4 million).

Profits after taxation of £49.8 million (2014 H1: £45.6 million) have been transferred to shareholders' funds, which totalled £952.5 million at the period end (31 March 2014: £909.9 million).

The Group analyses its results between the following segments, which are the principal divisions for which performance is monitored.

- Paragon Mortgages includes revenue, in the form of interest and ancillary income, from the Group's first mortgage operations, other than the buy-to-let lending of Paragon Bank, and from assets remaining in other, legacy, portfolios.
- Idem Capital includes revenue generated from assets purchased by the Group's debt investment business, Idem Capital Holdings Limited and third party loan administration activity.
- Paragon Bank includes revenue generated from the Group's regulated banking business, Paragon Bank PLC.

The underlying operating profits of these business segments are detailed fully in note 9 and are summarised below.

| | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 |
|---|---|---|
| | **£m** | £m |
| **Underlying profit / (loss)** | | |
| Paragon Mortgages | **44.7** | 39.8 |
| Idem Capital | **23.6** | 21.2 |
| Paragon Bank | **(4.4)** | (3.1) |
| | **63.9** | 57.9 |

HALF-YEAR FINANCIAL STATEMENTS

The Group's assets include

- First mortgage assets, with new originations and legacy assets in Paragon Mortgages, new originations in Paragon Bank and purchased assets in Idem Capital.
- Second mortgages, with new originations in Paragon Bank, legacy assets in Paragon Mortgages and purchased assets in Idem Capital.
- Car finance loans, with new originations in Paragon Bank and legacy assets in Paragon Mortgages.
- Other unsecured consumer lending with purchased assets in Idem Capital and legacy assets in Paragon Mortgages.

An analysis of the Group's financial assets by type is shown in note 13.

The information on related party transactions required by DTR 4.2.8(1) of the Disclosure and Transparency Rules is given in note 28, and a summary of the principal risks and uncertainties faced by the Group is given on pages 46 and 47.



# BUSINESS REVIEW

## OPERATING SEGMENTS

### Paragon Mortgages

Paragon Mortgages is one of the longest established lending brands in the buy-to-let mortgage market. Alongside its sister brand, Mortgage Trust, Paragon Mortgages maintains a significant presence for the Group in this growing sector of the UK mortgage market. Trading activity in the year has been strong, with the segment contributing £44.7 million to underlying Group profit (2014 H1: £39.8 million), an increase of 12.3%. The strong pipeline of new business, and the continued success of new business operations indicate a positive outlook for the second half of the financial year.

Total loan assets of the segment at 31 March 2015 were £8,993.5 million, 3.3% higher than the £8,707.6 million a year earlier, of which £8,749.2 million were buy-to-let mortgage assets (31 March 2014: £8,414.2 million).

***Buy-to-let***

| | Completions in period | | | Pipeline at period end | | |
|---|---|---|---|---|---|---|
| | **Six months ended 31 Mar 2015** | Six months ended 31 Mar 2014 | Year ended 30 Sep 2014 | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
| | **£m** | £m | £m | **£m** | £m | £m |
| Paragon Mortgages | **384.3** | 269.3 | 656.1 | **493.7** | 348.1 | 369.5 |
| Paragon Bank | **61.9** | - | 0.5 | **207.7** | - | 45.3 |
| Idem Capital | **-** | - | - | **-** | - | - |
| | **446.2** | 269.3 | 656.6 | **701.4** | 348.1 | 414.8 |

The background of robust growth in private renting and buy-to-let has provided a strong platform for further growth in buy-to-let lending for the Group in the first half of the financial year. As a result of improved access to funding through both Paragon Bank and the Group's continuing success in structured finance markets, the Group's mortgage business has been able to expand its proposition and compete more widely in its chosen markets.

The Group has maintained two distinct propositions, one targeting professional landlords and the other private investor landlords, which together ensured that it has maintained and developed its market position throughout the year. This has resulted in buy-to-let completions increasing by 65.7% to £446.2 million for the period (2014 H1: £269.3 million).

Further expansion of the Group's mortgage capacity, supported by improvements in funding costs, enabled the Group to increase business volumes significantly, resulting in a pipeline of new business (live cases between application and completion), of £701.4 million at the period end, £207.7 million of which was in Paragon Bank. This total was 69.1% greater than the £414.8 million at the end of September 2014 and supports growth levels into the second half of the financial year. The credit quality of the new lending business written in the year to date has remained excellent.

The introduction of tougher regulatory requirements for owner-occupier mortgages in the Spring of 2014 coincided with the onset of a period of weaker numbers in the housing market. However, by the end of 2014 there were signs that the dislocation caused by the new regulations was beginning to ease with a marked improvement in housing transactions, approvals and lending apparent by March 2015. Despite the disruption in the market, house prices have held up well with the two leading indices showing annual house price appreciation between 5.1% and 9.8% over the quarter ended 31 March 2015.

The private rented sector has continued to grow strongly. Data in the annual Survey of English Housing for 2013-14, published in February 2015 by the Department of Communities and Local Government indicated that the private rented sector, comprising 19% of households in England, is now larger than the social rented sector and remains the only growing form of tenure. In broad terms we continue to see a weakening of demand for owner-occupied housing, a static social rented sector and a private rented market that is expanding to fill the gap. Strong tenant demand has continued to drive demand for buy-to-let mortgages with Council of Mortgage Lenders ('CML') data for 2014 indicating some £27.4 billion of gross lending, an increase of 32% over the previous year. Whilst growth is strong, in real terms this is a continuation of the recovery rather than a 'boom' in buy-to-let, illustrated by the fact that buy-to-let lending in 2014 was little different to the levels seen ten years ago.

The Group has clearly been the beneficiary of growth in the buy-to-let market but it has also been able to capitalise on this growth as a result of the strong relationships it has in mortgage distribution and the dynamic approach that is taken to product development. The business constantly appraises the competitive position of its products in the market and conducts regular research amongst the landlord community to fine tune product offerings. Improved scale and cost of funding allows the Group to compete more effectively whilst maintaining margins and high credit standards.

The Group's outstanding buy-to-let balances are analysed below.

| | **Outstanding balances** | | |
|---|---|---|---|
| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
| | **£m** | £m | £m |
| Paragon Mortgages | **8,749.2** | 8,414.2 | 8,575.6 |
| Paragon Bank | **62.1** | - | 0.5 |
| Idem Capital | **15.3** | 16.8 | 16.0 |
| | **8,826.6** | 8,431.0 | 8,592.1 |

At 31 March 2015 the Group's buy-to-let portfolio stood at £8,826.6 million, compared with £8,431.0 million a year earlier. The annualised redemption rate on the overall buy-to-let book, although higher than the 3.4% reported for the first half of 2014, still remains low at 4.4%, despite the increasing numbers of post credit crisis accounts included in the portfolio, which we would be expected to redeem more quickly than the extant book. This performance indicates that the Group's landlord customers continue to display a long-term commitment to property investment.

The Group's approach to underwriting remains robust with a focus on the credit quality and financial capability of our customers which is underpinned by a detailed and thorough assessment of the value and suitability of the property as a security. This approach continues to deliver market leading credit performance across historic and current lending.

New loans continue to be of a high quality, with a good affordability profile, low average loan-to-value ratios and strong customer credit profiles. The credit performance of the portfolio over the year continued to be exemplary, with the percentage of loans three months or more in arrears (note 13) standing at 0.20% as at 31 March 2015 (31 March 2014: 0.30%, 30 September 2014: 0.25%) and remaining considerably better than the CML's comparable market average of 0.70% at that date (31 March 2014: 0.95%, 30 September 2014: 0.78%).

Security values have also benefitted from the effect of increased house prices. The Nationwide House Price Index showed appreciation in residential property values of 1.4% over the period, while the indexed loan-to-value ratio of the buy-to-let portfolio at 31 March 2015, at 72.0%, was broadly similar to its level at 30 September 2014. The increase in average prices, however, is part of a more volatile picture, which has been particularly marked at the local and regional level. The Group maintains a specialist team of in-house surveyors to maximise its understanding of particular markets, both from a valuation and lettings standpoint.

### *Other assets*

The Paragon Mortgages operating segment includes income generated from other, legacy, loan books, including owner-occupied mortgages, car loans, secured consumer loans and unsecured consumer loans. Save for the management of these books in run-off, there has been little activity in recent years in these areas. These assets form a very small part of the segment's results, when compared to buy-to-let assets and performed in line with our expectations. Their values are shown below.

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
|---|---|---|---|
| | **£m** | £m | £m |
| Owner-occupied mortgages | **53.6** | 66.6 | 59.6 |
| Secured loans | **184.9** | 218.8 | 201.0 |
| Unsecured loans | **5.8** | 8.0 | 6.7 |
| | **244.3** | 293.4 | 267.3 |

Although the Group has returned to lending in the car finance and secured loan markets, this new lending is through Paragon Bank and is reported under that segment.

## Idem Capital

In recent years, Idem Capital has established itself as one of the top consumer debt buyers in the UK, actively maintaining its strong relationship with the major UK based consumer debt sellers. In addition to assets acquired in its own right, Idem Capital services loans for third parties and for co-investment partners.

Idem Capital's portfolios continued to perform strongly in the first half of the financial year and, with new investments in the period and a continued focus on vigorous cost management, Idem Capital's contribution to underlying profit for the period increased by 11.3% to £23.6 million (2014 H1: £21.2 million).

At the end of March 2015, the 120 month gross estimated remaining collections ('ERC') for the Idem Capital portfolio stood at £639.2 million (31 March 2014: £705.6 million) (note 13). ERC is a standard measure of scale in the debt purchase industry, reflecting likely future cash flows from the acquired portfolios over the next ten years, which will reduce over time as balances are collected. At 31 March 2015, cumulative cash receipts totalled 105.8% of the values predicted at the point the loans were acquired (31 March 2014: 103.4%).

Activity in the UK debt purchase market has remained strong in the period with the major UK based financial institutions continuing to dispose of both paying and non-paying assets. Vendors have been actively reducing the size of their purchaser panels and, for paying debt, have been moving to a smaller number of larger trades as they execute their debt sale strategies, which contributes to a lumpy investment profile for organisations such as Idem Capital. The Group, including Idem Capital, has consistently applied a disciplined approach to pricing and the assessment of risk, something which is evident from the performance metrics in these results. Idem Capital has participated as a bidder in its own right and as a potential co-investor on several transactions in the period, investing £20.9 million in secured and unsecured loan portfolios (2014 H1: £121.9 million) and committing a further £8.0 million investment over the coming months under a forward flow arrangement. Idem remains engaged in a number of significant portfolio purchase opportunities, the sales processes for which are ongoing, and is well placed to add to its investments in the second half of the financial year.

Idem Capital's investments are summarised below.

| | Outstanding balance | | | Current year net investment | | |
|---|---|---|---|---|---|---|
| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
| | **£m** | £m | £m | **£m** | £m | £m |
| Loan portfolios | **389.2** | 398.0 | 407.2 | **20.9** | 121.9 | 175.7 |
| Co-investments | **17.7** | 20.6 | 19.3 | **-** | - | - |
| | **406.9** | 418.6 | 426.5 | **20.9** | 121.9 | 175.7 |

The outstanding value of Idem Capital's investments at 31 March 2015 totalled £406.9 million (31 March 2014: £418.6 million). Of this balance, 62.3% related to loans secured on property. The acquisition of loan portfolios during the period has resulted in the number of loan assets owned by Idem Capital increasing to 212,346 at 31 March 2015 (31 March 2014: 152,687).

The numbers of loan assets managed by Idem Capital and the wider Group are shown below.

| | **31 Mar 2015** | | 31 Mar 2014 | | 30 Sep 2014 | |
|---|---|---|---|---|---|---|
| | **Number** | **%** | Number | % | Number | % |
| Idem owned | **212,346** | **52.0%** | 152,687 | 38.3% | 191,454 | 46.1% |
| Third party | **118,379** | **29.0%** | 169,760 | 42.5% | 146,981 | 35.4% |
| Idem managed | **330,725** | **81.0%** | 322,447 | 80.8% | 338,435 | 81.5% |
| Group originated | **77,924** | **19.0%** | 76,629 | 19.2% | 76,890 | 18.5% |
| Group managed assets | **408,649** | **100.0%** | 399,076 | 100.0% | 415,325 | 100.0% |

The division utilises the Group's highly developed loan servicing and collection capability which is used for its own purchases and for co-invested and third party assets. The Group has invested heavily in its compliance infrastructure in recent years and is well placed to deliver the operational standards required by the UK regulatory authorities and by portfolio vendors.

During the period Idem Capital has continued to service loan portfolios on behalf of third parties. No new contracts were added in the period with the consequence that the number of loans managed for third parties fell to 118,379 at 31 March 2015 (31 March 2014: 169,760). New servicing portfolios may be added during the second half of the financial year, dependent on the successful conclusion of a number of co-investment opportunities in which Idem Capital is currently engaged as a bidding partner.

## Paragon Bank

Paragon Bank provides the Group with diversification of both income streams and funding sources. During the year ended 30 September 2014 Paragon Bank launched car finance, secured personal loan, buy-to-let mortgage and savings products, all of which it has continued to develop through the period. The Group had provided capital of £48.9 million to Paragon Bank before the start of the period and expects to provide additional capital over time to support its growth. The initial costs of developing the Bank's business and product offerings, together with the fixed costs necessitated by the regulatory environment in which it operates, resulted in an underlying loss for the period in this segment of £4.4 million (2014 H1: £3.1 million), in line with expectations. This will reduce as the Bank's increasing loan book begins to generate more interest income.

The new lending businesses within Paragon Bank all became operational within the last twelve months. The car finance and secured personal finance businesses are new operations and as a result have focussed on establishing distribution, with only modest lending volumes achieved. Buy-to-let loans are generated through existing Group channels and as a result volume growth has been strongest in this area. The developments in all business streams should however, lead to significant growth in lending going forward.

Paragon Bank's loan assets at 31 March 2015 are summarised below.

| | Outstanding balance | | | Current period advances | | |
|---|---|---|---|---|---|---|
| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
| | **£m** | £m | £m | **£m** | £m | £m |
| Buy-to-let | **62.1** | - | 0.5 | **61.9** | - | 0.5 |
| Car finance | **19.7** | 0.3 | 5.3 | **15.7** | 0.3 | 5.3 |
| Personal finance | **3.8** | - | - | **3.8** | - | - |
| | **85.6** | 0.3 | 5.8 | **81.4** | 0.3 | 5.8 |

Paragon Bank continues to investigate further product developments, where these match its risk appetite. In addition to organic product development, it intends to work with the Idem Capital team where potential asset purchases fit with its risk appetite and business model, thereby broadening the scope of both parts of the Group.

During September 2014 Paragon Bank commenced offering buy-to-let mortgages, using the Group's existing systems and distribution channels, with distinct and complementary products to those offered by Paragon Mortgages. During the six months ended 31 March 2015, £61.9 million of advances were made with a pipeline of £207.7 million at that date. The buy-to-let market is discussed in more detail under 'Paragon Mortgages' above.

The UK car market has continued to grow during the period. Calendar year-to-date registrations to 31 March 2015 were 735,000 which is a 7.0% increase on the same period in 2014. The UK car finance market has also experienced considerable growth with the Finance and Leasing Association ('FLA') reporting total finance granted in the six months ended 31 March 2015 up 12.4% at £12.7 billion (2014 H1: £11.3 billion). Paragon Bank launched Paragon Car Finance in February 2014 and has progressed in the establishment of its dealer panel and the promotion of products that meet the new regulatory requirements established following the transfer of responsibility for the regulation of consumer credit from the Office of Fair Trading to the Financial Conduct Authority ('FCA') in April 2014.

The secured personal loans market has enjoyed successive year-on-year growth since October 2012. Statistics released by the FLA for the six months ended 31 March 2015 showed year-on-year growth of 22.0% to £327 million (2014 H1: £268 million). Paragon Bank entered the market on 30 September 2014 with an experienced workforce recruited from the Group's previous secured loan business. The initial activity focussed on ensuring systems perform as expected followed by the strengthening of the broker distribution network. Initial broker feedback has been very encouraging.

## Savings

The UK savings market continues to grow strongly, with household balances increasing by over £16 billion in the six months to 31 March 2015. This strong supply has helped to maintain the recent trend for low savings rates, which were largely unchanged over the period.

Paragon Bank offered its first savings accounts to new customers in June 2014 and has since expanded its savings activity, diversified its product range and invested in advertising. Accounts are offered through the internet and include fixed term and notice savings products.

Retail deposits at 31 March 2015 had reached £165.0 million increasing 174.5% in the period (30 September 2014: £60.1 million). This success was also reflected in Paragon Bank being named as Best New Savings Provider at the fifth annual Moneyfacts Awards in February 2015.

The Bank's savings product range remains reflective of its stage of development, with a focus on attracting term funding to manage interest rate risk. The savings business has the capability and capacity to grow as the Bank's funding requirements increase.

We expect to build on this initial success whilst continuing to serve those savers looking for a combination of straightforward processes and competitive products.

## REGULATION

HM Treasury has published the final legislation necessary to implement the Mortgage Credit Directive and move second charge mortgages from the FCA's consumer credit regime to its residential mortgage regime with effect from March 2016. The FCA has also published its final rules to effect these changes. In relation to second charge lending, we shall apply to the FCA for the authorisations required by these changes in good time before March 2016 but do not believe that either the implementation of the Directive or change of regime for second charge mortgages will have a material impact on the operation of any of our businesses.

In relation to the Directive, the only change relevant to the Group's current activities is to extend appropriate regulation to the origination, administration and broking of buy-to-let loans to consumers, as defined by the Directive. We shall seek the registrations required by these changes but as these comprise only a small portion of the Group's overall buy-to-let operations, believe they will have little impact on our activities.

All relevant Group companies hold the requisite interim permissions from the FCA under the new consumer credit regime and have been allocated a prescribed period within which to make applications for full authorisation.

Paragon Bank is regulated by the Prudential Regulation Authority ('PRA') and the FCA and the Group is subject to consolidated supervision by the PRA. The current and projected rate of regulatory change in this environment, driven by domestic and European policy, is significant. The governance and control structure within Paragon Bank and the wider Group has been established and developed to ensure that the impact of new requirements on the business are clearly understood and planned for.



# FUNDING REVIEW

Benign conditions in the Group's principal funding markets continued during the first half of the financial year. Swap rates and gilt yields have declined progressively and the absolute cost of funds remains near historical lows. Concerns over the UK election and Greece's negotiations within the EU have been muted and volatility was subdued despite the United States continuing to signal that a rise in its interest rates may be imminent. Supply in the UK Residential Mortgage Backed Securities ('RMBS') market has been increasing steadily and was readily absorbed by investors, with spreads broadly unchanged since the year end. Terms in the banking market continue to improve and this is driving an increased risk appetite in markets generally.

The Group continued its strategy of diversifying its funding sources by accessing euro denominated investors with the latest securitisation, Paragon Mortgages (No. 22) PLC. The euro tranche was significantly oversubscribed and the Group will monitor the possibility of executing further euro transactions during the remainder of the year.

Buy-to-let mortgage originations outside of Paragon Bank are initially funded through three revolving warehouse facilities which totalled £550.0 million at 31 March 2015. The improved terms on the facility with Macquarie Bank agreed in the previous year came into effect during the period and the facility with Natixis came into use. Following the period end, the Group added a further £200.0 million to its available warehouse facilities, bringing total capacity to £750.0 million. This enhanced capacity within the Group, together with further flows being financed by Paragon Bank, supports our growth plans in the buy-to-let market.

In the longer term, buy-to-let mortgage loans are funded through the securitisation markets. Two new public securitisation deals totalling £550.0 million, with senior notes rated AAA were completed in the period. The Group's 59th transaction, Paragon Mortgages (No. 21) PLC, for £250.0 million, completed in November 2014, with Paragon Mortgages (No. 22) PLC, for £300.0 million, following in March 2015.

Increased supply in the RMBS markets has resulted in interest margins on new issuance being largely unchanged during the first six months of the financial year. The increase in the number of transactions using pre-2008 mortgage collateral or with impaired credit underwriting, has been particularly notable, reflecting the increasing willingness of investors to take risk. These transactions have offered higher margins than those with newly originated prime collateral such as the Group's offerings.

Idem Capital has continued with its funding strategy of financing smaller scale acquisitions from the Group's equity while keeping under review the opportunities to introduce external funding when asset volumes make that economically appropriate. Paragon Bank's lending is funded through its savings deposits.

While the Group's working capital has been primarily provided by internal cash generation since 2008, in recent years it has expanded its use of corporate debt funding, allowing it to diversify its funding base and extend the tenor of its borrowings.

The Group is now rated by Fitch Ratings, which has ascribed it an initial BBB- rating. With a strategy to increase holding company leverage levels over time, the rating will support long dated corporate debt issuance in both scale and pricing terms. The achievement of this investment grade rating represents a further significant development in the Group's growth and diversification strategy.

Further information on all of the above borrowings is given in note 23.

These developments in the Group's sources of finance both extend and diversify its funding, better placing it to deliver future sustainable growth. The Group has a medium term strategic objective to achieve balance between securitised and retail deposit funding for its new lending activities.



## CAPITAL MANAGEMENT

The Group has continued to enjoy strong cash generation during the year. Free cash balances were £206.7 million at 31 March 2015 (30 September 2014: £177.3 million) (note 16) after investments to support new buy-to-let originations and acquisitions by Idem Capital. The Company sees opportunities going forward to deploy capital for new lending activities, which should continue to increase, and to invest further amounts in loan portfolios through Idem Capital as banks and other financial institutions continue to dispose of assets. These cash balances, together with future operational cash flow, will support the Group's growth through investment in these areas.

In pursuance of its dividend policy and in view of the strong position of the Group and its confidence in the prospects for the business, the Board proposes an interim dividend of 3.6p per share (2014 H1: 3.0p) payable to shareholders on the register on 3 July 2015, representing an increase of 20.0% from 2014.

PRA supervision of the Group imposes consolidated capital adequacy rules upon it. The Group maintains extremely strong capital and leverage ratios, with a CET1 ratio of 19.5% at 31 March 2015 (30 September 2014: 19.7%) and a leverage ratio at 8.1% (30 September 2014: 8.2%) (note 4), leaving the Group's capital at 31 March 2015 comfortably in excess of the regulatory requirement.

The Board keeps under review the appropriate level of capital for the business to meet its operational requirements and strategic development objectives. The strength of the Paragon Mortgages and Idem Capital businesses, the diversification which has been achieved in the funding base in recent years and the further opportunities for growth and sustainability provided by Paragon Bank, have now created the foundations on which to develop the Group's next phase of growth.

In view of the strong capital base and low leverage in the Company's balance sheet, the Board has determined that the Group's debt and equity capital resources should be rebalanced to deliver returns at a higher rate to shareholders. To enhance this strategy the Group regularly reviews the opportunities available to it to access the sterling senior unsecured debt market and the UK retail bond market to add incremental long-dated debt to the Group balance sheet.

During the period the Group commenced a share buy-back programme, initially for up to £50.0 million, to be reviewed periodically to take account of anticipated investment opportunities and the balance of the Group's debt and equity capital resources. In the six months ended 31 March 2015 the Group had bought back 4.1 million of its ordinary shares at a cost of £17.2 million, which are held in treasury (note 20). The buy-back programme will continue through the rest of the financial year, and these shares will also be held in treasury.

# MANAGEMENT AND PEOPLE

During the year ended 30 September 2014, the Board reviewed the governance arrangements for the Group. For the purposes of succession planning and to ensure that the Board had in place sufficient non-executive directors to maintain its independence balance in the future (taking into account the dates at which the current non-executive directors would cease to be independent under the requirements of the UK Code on Corporate Governance), it determined that an additional non-executive director should be appointed. It also considered that the increasing demands placed on non-executive directors by the growing size and complexity of the Group further supported this decision.

On 24 November 2014, Hugo Tudor was appointed to the Board as a non-executive director. He spent 26 years in the fund management industry, originally with Schroders and most recently with BlackRock, covering a wide range of UK equities. He is a Chartered Financial Analyst and a Chartered Accountant and brings a strong strategic and investor perspective to the Board.

After seven years with the Group, the Senior Independent Director, Edward Tilly, has expressed his intention not to seek re-election as a director at the 2016 Annual General Meeting. The Board has asked Fiona Clutterbuck to succeed Mr Tilly as Senior Independent Director on his retirement. Arrangements to ensure a smooth transfer of responsibilities will be put in place during the summer and the date on which this change will formally take place will be announced in due course.

Our people are important to us and to the future growth and development of the Group. The training and development of our employees together with our rigorous recruitment process are a key part of the Group's organic growth strategy and underpin the strong progress it has made. During the period an internal Management Academy, accredited by the Chartered Management Institute, was launched, helping to support the growth of the business.

The Group sees the Living Wage as an important part of our values and our people strategy and supports the Living Wage Foundation's principle of it being good for business, good for the individual and good for society. The Group continues with its plans to adopt the UK Living Wage standard by the end of the current financial year. During the period the Group exceeded 1,000 employees as its operations expand and had reached 1,029 by the end of the period, while staff turnover remains low with an average length of service of eight years, twice the national average.

In May 2014 the Group achieved Investor in People Champion status, placing it in the top 1% of companies in the UK and has been shortlisted in the reward and recognition category in June's forthcoming annual Investors in People awards.

# CONCLUSION

These results are particularly pleasing in that they demonstrate how far the business has progressed in its strategy as a leading specialist lender. The delivery of increasing profits, 10.4% ahead of the comparable period last year, has been achieved whilst the Group has also made considerable investment supporting its growth prospects for the future.

The Group's strong progress in the six months to March 2015 has been most notable in the buy-to-let business. Combined Paragon Mortgages and Paragon Bank buy-to-let completion volumes were up 65.7% on the levels achieved during the period to March 2014. The new buy-to-let business pipeline has more than doubled in the same period, underpinning further growth for the second half. Paragon Bank, now in its second year, has made excellent progress in the deposit market, with savings balances having risen to £165.0 million at the period end and in excess of £250.0 million at the point of the results announcement, with the potential to add to this as and when required. Paragon Bank's consumer finance distribution channels are developing and the momentum of new lending volumes is encouraging. The bank remains on track to break-even in 2016, less than three years after launch, and is expected to represent an increasing proportion of the Group's new business activities going forward. Whilst Idem Capital's investment volumes were down period on period, there is a strong pipeline of opportunities. The Group has a disciplined and rigorous approach to credit and conduct risk, as well as pricing, across all its divisions, which is evident through the performance of its loan portfolios. These high standards will continue to be applied for new business activity, including within Idem Capital.

The growth being achieved this year and expected in the future reflects the significant progress made in broadening the Group's funding capacity. The achievement of an investment grade corporate rating, accessing the deep European investor base in its latest securitisation, increasing warehouse capacity and growing its deposit-raising franchise all demonstrate further significant progress in its funding diversification strategy.

Whilst the Group's businesses are growing their market share and franchise, the markets in which they operate are themselves displaying good growth prospects and this is expected to continue. Additional specialist lending product opportunities will also emerge going forward and the combination of a robust capital base, increasingly strong and diversified funding sources, a focus on providing value adding products and services to its customers and a highly cost efficient operating model will provide a platform from which to exploit these opportunities.

The Group's increasing focus towards enhancing shareholder returns, whilst maintaining a strong capital position, has made good progress and remains a core objective.

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors confirm that, to the best of their knowledge:

- the condensed financial statements have been prepared in accordance with International Accounting Standard 34 – 'Interim Financial Reporting';
- the Interim Management Report includes a fair review of the information required by Section 4.2.7R of the Disclosure and Transparency Rules, issued by the UK Listing Authority (indication of important events that have occurred during the first six months of the current financial year and their impact on the condensed financial statements and description of the principal risks and uncertainties for the remaining six months of the financial year); and
- the Interim Management Report includes a fair review of the information required by Section 4.2.8R of the Disclosure and Transparency Rules, issued by the UK Listing Authority (disclosure of related party transactions that have taken place in the first six months of the financial year and that have materially affected the financial position or the performance of the enterprise during that period; and any changes in the related party transactions described in the last annual report which could do so).

Approved by the Board of Directors and signed on behalf of the Board.

**PANDORA SHARP**
Company Secretary
19 May 2015

## Board of Directors

| | | |
|---|---|---|
| R G Dench | J A Heron | P J N Hartill |
| N S Terrington | E A Tilly | F J Clutterbuck |
| R J Woodman | A K Fletcher | H R Tudor |

# CONDENSED FINANCIAL STATEMENTS

## CONSOLIDATED INCOME STATEMENT

For the six months ended 31 March 2015 (Unaudited)



| | Note | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|---|
| | | **£m** | £m | £m |
| Interest receivable | | **164.7** | 143.9 | 302.4 |
| Interest payable and similar charges | | **(67.5)** | (56.9) | (123.0) |
| **Net interest income** | | **97.2** | 87.0 | 179.4 |
| Other operating income | 6 | **6.8** | 9.4 | 18.5 |
| **Total operating income** | | **104.0** | 96.4 | 197.9 |
| Operating expenses | | **(36.6)** | (31.0) | (63.4) |
| Provisions for losses | | **(3.5)** | (7.5) | (12.3) |
| **Operating profit before fair value items** | | **63.9** | 57.9 | 122.2 |
| Fair value net (losses) / gains | 8 | **(1.3)** | 0.3 | 0.6 |
| **Operating profit being profit on ordinary activities before taxation** | | **62.6** | 58.2 | 122.8 |
| Tax charge on profit on ordinary activities | 10 | **(12.8)** | (12.6) | (25.6) |
| **Profit on ordinary activities after taxation** | | **49.8** | 45.6 | 97.2 |

| | Note | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|---|
| Dividend – Rate per share for the period | 19 | **3.6p** | 3.0p | 9.0p |
| Basic earnings per share | 11 | **16.3p** | 15.0p | 31.9p |
| Diluted earnings per share | 11 | **16.0p** | 14.6p | 31.1p |

The results for the periods shown above relate entirely to continuing operations.

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Six months ended 31 March 2015 (Unaudited)

| | Note | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|---|
| | | **£m** | £m | £m |
| **Profit for the period** | | **49.8** | 45.6 | 97.2 |
| | | | | |
| **Other comprehensive income / (expenditure)** | | | | |
| *Items that will not be reclassified subsequently to profit or loss* | | | | |
| Actuarial (loss) / gain on pension plan | *24* | **(8.8)** | 3.4 | (2.1) |
| Tax thereon | | **1.8** | (0.7) | 0.4 |
| | | **(7.0)** | 2.7 | (1.7) |
| *Items that may be reclassified subsequently to profit or loss* | | | | |
| Cash flow hedge (losses) taken to equity | | **(2.5)** | (0.7) | (1.4) |
| Tax thereon | | **0.5** | 0.2 | 0.3 |
| | | **(2.0)** | (0.5) | (1.1) |
| | | | | |
| Other comprehensive (expenditure) / income for the period net of tax | | **(9.0)** | 2.2 | (2.8) |
| **Total comprehensive income for the period** | | **40.8** | 47.8 | 94.4 |

# CONSOLIDATED BALANCE SHEET

31 March 2015 (Unaudited)

| | Note | 31 Mar 2015 £m | 31 Mar 2014 £m | 30 Sep 2014 £m | 30 Sep 2013 £m |
|---|---|---|---|---|---|
| **Assets employed** | | | | | |
| **Non-current assets** | | | | | |
| Intangible assets | 12 | **7.6** | 8.2 | 7.9 | 8.5 |
| Property, plant and equipment | | **22.8** | 23.4 | 22.9 | 9.6 |
| Financial assets | 13 | **10,300.2** | 9,884.1 | 9,969.6 | 9,715.3 |
| | | **10,330.6** | 9,915.7 | 10,000.4 | 9,733.4 |
| **Current assets** | | | | | |
| Other receivables | | **6.1** | 6.6 | 6.5 | 7.6 |
| Short term investments | 15 | **48.5** | 0.5 | 39.4 | - |
| Cash and cash equivalents | 16 | **812.6** | 716.3 | 848.8 | 587.3 |
| | | **867.2** | 723.4 | 894.7 | 594.9 |
| Total assets | | **11,197.8** | 10,639.1 | 10,895.1 | 10,328.3 |
| **Financed by** | | | | | |
| **Equity shareholders' funds** | | | | | |
| Called-up share capital | 17 | **308.9** | 307.1 | 307.3 | 306.2 |
| Reserves | 18 | **709.0** | 649.5 | 688.0 | 614.7 |
| Share capital and reserves | | **1,017.9** | 956.6 | 995.3 | 920.9 |
| Own shares | 20 | **(65.4)** | (46.7) | (48.2) | (47.6) |
| Total equity | | **952.5** | 909.9 | 947.1 | 873.3 |
| **Current liabilities** | | | | | |
| Financial liabilities | 21 | **101.3** | 1.0 | 54.4 | 3.0 |
| Current tax liabilities | | **11.4** | 10.1 | 11.9 | 5.9 |
| Other liabilities | | **36.2** | 35.4 | 40.1 | 36.2 |
| | | **148.9** | 46.5 | 106.4 | 45.1 |
| **Non-current liabilities** | | | | | |
| Financial liabilities | 21 | **10,061.5** | 9,659.6 | 9,814.0 | 9,383.4 |
| Retirement benefit obligations | 24 | **26.0** | 12.2 | 17.3 | 15.7 |
| Deferred tax | | **8.7** | 10.6 | 10.1 | 9.9 |
| Other liabilities | | **0.2** | 0.3 | 0.2 | 0.9 |
| | | **10,096.4** | 9,682.7 | 9,841.6 | 9,409.9 |
| Total liabilities | | **10,245.3** | 9,729.2 | 9,948.0 | 9,455.0 |
| | | **11,197.8** | 10,639.1 | 10,895.1 | 10,328.3 |

The condensed financial statements for the half year were approved by the Board of Directors on 19 May 2015.

# CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 31 March 2015 (Unaudited)

| | Note | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|---|
| | | **£m** | £m | £m |
| Net cash flow (utilised) by operating activities | *25* | **(47.5)** | (246.4) | (269.5) |
| Net cash (utilised) by investing activities | *26* | **(10.2)** | (25.7) | (65.2) |
| Net cash generated by financing activities | *27* | **22.4** | 401.5 | 596.5 |
| **Net (decrease) / increase in cash and cash equivalents** | | **(35.3)** | 129.4 | 261.8 |
| Opening cash and cash equivalents | | **847.7** | 585.9 | 585.9 |
| **Closing cash and cash equivalents** | | **812.4** | 715.3 | 847.7 |
| Represented by balances within | | | | |
| - Cash and cash equivalents | *16* | **812.6** | 716.3 | 848.8 |
| - Financial liabilities | | **(0.2)** | (1.0) | (1.1) |
| | | **812.4** | 715.3 | 847.7 |

# CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY

Six months ended 31 March 2015 (Unaudited)

| | Note | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|---|
| | | **£m** | £m | £m |
| Total comprehensive income for the period | | **40.8** | 47.8 | 94.4 |
| Dividends paid | *19* | **(18.3)** | (14.6) | (23.7) |
| Net movement in own shares | | **(17.2)** | 0.9 | (0.6) |
| Deficit on transactions in own shares | | **(3.9)** | (0.8) | (0.8) |
| Charge for share based remuneration | | **2.6** | 1.6 | 3.2 |
| Tax on share based remuneration | | **1.4** | 1.7 | 1.3 |
| **Total movements in equity in the period** | | **5.4** | 36.6 | 73.8 |
| Opening equity | | **947.1** | 873.3 | 873.3 |
| **Closing equity** | | **952.5** | 909.9 | 947.1 |

# SELECTED NOTES TO THE ACCOUNTS

For the six months ended 31 March 2015 (Unaudited)

## 1. GENERAL INFORMATION

The condensed financial statements for the six months ended 31 March 2015 and for the six months ended 31 March 2014 have not been audited, as defined in section 434 of the Companies Act 2006.

The figures shown above for the years ended 30 September 2014 and 30 September 2013 are not statutory accounts. A copy of the statutory accounts for each year has been delivered to the Registrar of Companies. The auditors reported on those statutory accounts and their reports were unqualified, did not draw attention to any matters by way of emphasis and did not contain an adverse statement under sections 498 (2) or 498 (3) of the Companies Act 2006.

Sections of this half-yearly report, including but not limited to the Interim Management Report, may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These have been made by the directors in good faith using information available up to the date on which they approved this report. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a profit forecast.

A copy of the half-yearly financial report will be posted to those shareholders who have requested to receive one and additional copies can be obtained from the Company Secretary, The Paragon Group of Companies PLC, 51 Homer Road, Solihull, West Midlands, B91 3QJ.

This half-yearly financial report is available on the Group's website at www.paragon-group.co.uk.

## 2. ACCOUNTING POLICIES

The condensed financial statements are presented in accordance with the requirements of International Accounting Standard 34 – 'Interim Financial Reporting'.

The Group prepares its annual financial statements in accordance with International Financial Reporting Standards as endorsed by the European Union. The condensed financial statements have been prepared on the basis of the accounting policies set out in the Annual Report and Accounts of the Group for the year ended 30 September 2014, which are expected to be used in the preparation of the financial statements of the Group for the year ending 30 September 2015.

### Going concern basis

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Interim Management Report on pages 7 to 18. The principal risks and uncertainties affecting the Group in the forthcoming six months are described on pages 46 and 47.

Note 6 to the accounts for the year ended 30 September 2014 includes an analysis of the Group's working capital position and policies, while note 7 includes a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Note 5 to those accounts discusses critical accounting estimates affecting the results and financial position disclosed therein. The position and policies described in these notes remain materially unchanged to the date of this half-yearly report, except as described in note 23.

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed plans are produced for a rolling 24 month period with longer term forecasts covering a 5 year period. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short term and strategic basis.

The Group's securitisation funding structures ensure that both a substantial proportion of its originated loan portfolio and a significant amount of its acquired Idem Capital assets are match-funded. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations utilising the Group's available warehouse facilities are refinanced through securitisation from time to time.

The Group's retail deposits of £165.0m (note 22), accepted through Paragon Bank are repayable within five years, though only 61.3% of this balance (£101.1m) is payable within twelve months. The liquidity exposure represented by these deposits is monitored; a process supervised by the Asset and Liability Committees of the Group and Paragon Bank. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 31 March 2015 Paragon Bank held £121.2m in liquid assets, £48.5m of short term investments (note 15) and £72.7m of cash (note 16).

None of the Group's working capital debt matures before 2017, when the £110.0m corporate bond is repayable. The outstanding principal balance of the Group's retail bonds at 31 March 2015 was £185.0m, none of which is repayable before December 2020.

At 31 March 2015 the Group had free cash balances of £206.7m immediately available for use (note 16).

As described in note 4 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 31 March 2015 was in excess of regulatory requirements and its forecasts show this continuing to be the case.

Having considered all of the factors described above the directors believe that the Group is well placed to manage its business risks, including solvency and liquidity risks, successfully.

After making enquiries, the directors have a reasonable expectation that the Group will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the half-yearly report.

## 3. FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Fair values have been determined for all derivatives, listed securities and any other financial assets and liabilities for which an active and liquid market exists.

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate. The principal inputs to these valuation models are LIBOR benchmark interest rates for the currencies in which the instruments are denominated, sterling, euros and dollars. The cross currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. In order to determine the fair values, management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors.

For assets and liabilities carried at fair value, IFRS 7 requires that the measurements should be classified using a fair value hierarchy reflecting the inputs used, and defines three levels. Level 1 measurements are unadjusted market prices, level 2 measurements are derived from observable data, such as market prices or rates, while level 3 measurements rely on significant inputs which are not derived from observable data. As described above the valuations of the Group's derivatives are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 14. The short term investments described in note 15 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements. The Group had no financial assets or liabilities in the year ended 30 September 2013, year ended 30 September 2014 or the six months ended 31 March 2015 valued using level 3 measurements.

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises. While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it. As these valuation exercises are not wholly market based they are considered to be level 2 measurements.

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. On this basis they have concluded that the carrying value of these liabilities, determined on the amortised cost basis, is not significantly different from their fair value derived on a discounted cash flow basis. Given the mixture of observable and non-observable inputs, these are considered to be level 2 measurements.

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. On this basis they have concluded that the carrying value of these assets, determined on the amortised cost basis, is not significantly different from the fair value of the assets derived on a discounted cash flow basis. Given the mixture of observable and non-observable inputs these are considered to be level 2 measurements.



## 4. CAPITAL MANAGEMENT

The Group's objectives in managing capital are:

- To ensure that the Group has sufficient capital to meet its operational requirements and strategic objectives;
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders;
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk; and
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements.

The Group sets the amount of capital in proportion to risk, availability and cost. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

Following the authorisation of Paragon Bank by the Prudential Regulation Authority ('PRA') in the year ended 30 September 2014, the Group became subject to regulatory capital rules on a consolidated basis. This is discussed further below.

### (a) Return on equity

Return on equity is defined by the Group by comparing the profit after tax for the period to the average of the opening and closing equity positions and is derived as follows:

| | *Note* | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|---|
| | | **£m** | £m | £m | £m |
| Profit for the period | | **49.8** | 45.6 | 97.2 | 84.7 |
| **Divided by** | | | | | |
| Opening equity | | **947.1** | 873.3 | 873.3 | 803.5 |
| Closing equity | | **952.5** | 909.9 | 947.1 | 873.3 |
| Average equity | | **949.8** | 891.6 | 910.2 | 838.4 |
| Return on equity (annualised) | | **10.8%** | 10.5% | 10.7% | 10.1% |

### (b) Gearing

The Board of Directors regularly review the proportion of working capital represented by debt and equity. Net debt is calculated as total debt, other than securitised and warehouse debt, valued at principal value, less free cash up to a maximum of the total debt. Adjusted equity comprises all components of equity (i.e. share capital, share premium, minority interest, retained earnings, and revaluation surplus) other than amounts recognised in equity relating to cash flow hedges.

The debt and equity amounts at 31 March 2015 were as follows:

| | *Note* | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|---|
| | | **£m** | £m | £m | £m |
| **Debt** | | | | | |
| Corporate bond | | **110.0** | 110.0 | 110.0 | 110.0 |
| Retail bonds | | **185.0** | 185.0 | 185.0 | 60.0 |
| Bank overdraft | | **0.2** | 1.0 | 1.1 | 1.4 |
| Less: Applicable free cash | | **(206.7)** | (169.4) | (177.3) | (170.8) |
| Net debt | | **88.5** | 126.6 | 118.8 | 0.6 |
| | | | | | |
| **Equity** | | | | | |
| Total equity | | **952.5** | 909.9 | 947.1 | 873.3 |
| Less: cash flow hedging reserve | | **1.4** | (1.2) | (0.6) | (1.7) |
| Adjusted equity | | **953.9** | 908.7 | 946.5 | 871.6 |
| **Total working capital** | | **1,042.4** | 1,035.3 | 1,065.3 | 872.2 |
| | | | | | |
| Debt | | **8.5%** | 12.2% | 11.2% | 0.1% |
| Equity | | **91.5%** | 87.8% | 88.8% | 99.9% |
| **Total working capital** | | **100.0%** | 100.0% | 100.0% | 100.0% |

The movements in the proportion of working capital represented by debt and equity during the period resulted primarily from the operation of the policy described above.

## (c) Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision the regulator issues individual capital guidance setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive ('CRD IV'), which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors against the risk of losses being incurred by the Group.

The Group's regulatory capital is monitored by the Board of Directors, its Risk and Compliance Committee and the Asset and Liability Committee, who ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

At 31 March 2015 the Group's regulatory capital of £981.9m (31 March 2014: £964.2m, 30 September 2014: £981.1m) was comfortably in excess of that required by the regulator. Although the Group was not subject to supervision at 30 September 2013, disclosures at that date are provided in this section for comparative purposes.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 31 March 2015 is set out below.

| | *Note* | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|---|
| | | **£m** | £m | £m | £m |
| Total equity | | **952.5** | 909.9 | 947.1 | 873.3 |
| **Deductions** | | | | | |
| Proposed dividend | *19* | **(10.9)** | (9.1) | (18.3) | (14.6) |
| Intangible assets | *12* | **(7.6)** | (8.2) | (7.9) | (8.5) |
| Deferred tax adjustment | * | **(0.5)** | (0.5) | (0.5) | (0.6) |
| **Common Equity Tier 1 ('CET1') capital** | | **933.5** | 892.1 | 920.4 | 849.6 |
| Other tier 1 capital | | **-** | - | - | - |
| **Total Tier 1 capital** | | **933.5** | 892.1 | 920.4 | 849.6 |
| Corporate bond | | **110.0** | 110.0 | 110.0 | 110.0 |
| Less: amortisation adjustment | † | **(64.8)** | (42.8) | (53.8) | (31.8) |
| | | **45.2** | 67.2 | 56.2 | 78.2 |
| Collectively assessed credit impairment allowances | | **3.2** | 4.9 | 4.5 | 6.2 |
| **Total Tier 2 capital** | | **48.4** | 72.1 | 60.7 | 84.4 |
| **Total regulatory capital** | | **981.9** | 964.2 | 981.1 | 934.0 |

* Deferred tax assets in subsidiary companies are required to be deducted from regulatory capital. This balance is offset against the deferred tax liability in the consolidated accounts.

† When tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum on a straight line basis. The Group's £110m Corporate Bond matures in 2017 and therefore such an amortisation adjustment is required.

The total risk exposure calculated under the CRD IV framework, against which this capital is held, and the proportion of this exposure it represents, are calculated as shown below.

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
|---|---|---|---|
| | **£m** | £m | £m |
| Credit risk | | | |
| - Balance sheet assets | **4,231.8** | 4,118.8 | 4,146.6 |
| - Off balance sheet | **110.3** | 48.1 | 74.2 |
| Total credit risk | **4,342.1** | 4,166.9 | 4,220.8 |
| Operational risk | **337.1** | 307.7 | 337.1 |
| Market risk | **-** | - | - |
| Other | **104.8** | 111.0 | 108.7 |
| **Total risk exposure** | **4,784.0** | 4,585.6 | 4,666.6 |
| | | | |
| **Solvency ratios** | **%** | % | % |
| CET1 | **19.5%** | 19.5% | 19.7% |
| Total regulatory capital | **20.5%** | 21.0% | 21.0% |

The CRD IV risk weightings for credit risk exposures are calculated using the Standardised Approach. Operational risk is calculated using the Basic Indicator Approach.

The table below shows the calculation of the leverage ratio, based on the consolidated balance sheet assets adjusted as shown below.

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
|---|---|---|---|
| | **£m** | £m | £m |
| Total balance sheet assets | **11,197.8** | 10,639.1 | 10,895.1 |
| Less: Intangible assets | **(7.6)** | (8.2) | (7.9) |
| Balance sheet leverage exposure | **11,190.2** | 10,630.9 | 10,887.2 |
| Post offer pipeline | **308.5** | 137.3 | 209.8 |
| Potential future exposure on derivatives | **73.0** | 70.8 | 70.7 |
| Total leverage exposure | **11,571.7** | 10,839.0 | 11,167.7 |
| | | | |
| Tier 1 capital | **933.5** | 892.1 | 920.4 |
| **Leverage ratio** | **8.1%** | 8.2% | 8.2% |

The Group has revised its calculation of the leverage ratio above to take account of the revised rules for leverage disclosures in CRD IV.

The regulatory capital disclosures in these financial statements relate only to the consolidated position for the Group. Individual entities within the Group are also subject to supervision on a standalone basis. All such entities complied with the requirements to which they were subject during the period.

## 5. SEGMENTAL RESULTS

The Group uses an analysis of its operations based on the entities within the Group generating its assets for management reporting purposes and therefore the segments presented in this condensed financial information have been determined in a similar way. The segments used are described below.

- Paragon Mortgages includes revenue, in the form of interest and ancillary income, from the Group's first mortgage operations, other than the buy-to-let lending of Paragon Bank, and from assets remaining in other, legacy, portfolios.
- Idem Capital includes revenue generated from assets purchased by the Group's debt investment business, Idem Capital Holdings Limited and third party loan administration activity.
- Paragon Bank includes revenue, in the form of interest and ancillary income, generated from the Group's regulated banking business, Paragon Bank PLC.

Each of these businesses invests in consumer finance assets, and an analysis of the Group's financial assets by type is shown in note 13.

Dedicated financing and administration costs of each of these businesses are allocated to the segment and shared costs, and the financing costs of the Group's working capital invested, are allocated based on the segments' use of those resources.

Financial information about these business segments is shown below.

### Six months ended 31 March 2015

| | Paragon Mortgages | Idem Capital | Paragon Bank | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| Interest receivable | 128.6 | 35.0 | 1.1 | 164.7 |
| Interest payable | (61.4) | (5.1) | (1.0) | (67.5) |
| Net interest income | 67.2 | 29.9 | 0.1 | 97.2 |
| Other operating income | 4.0 | 2.8 | - | 6.8 |
| Total operating income | 71.2 | 32.7 | 0.1 | 104.0 |
| Operating expenses | (23.0) | (9.1) | (4.5) | (36.6) |
| Provisions for losses | (3.5) | - | - | (3.5) |
| | 44.7 | 23.6 | (4.4) | 63.9 |
| Fair value net (loss) / gain | (1.2) | - | (0.1) | (1.3) |
| Operating profit / (loss) | 43.5 | 23.6 | (4.5) | 62.6 |
| Tax charge | | | | (12.8) |
| Profit after taxation | | | | 49.8 |

### Six months ended 31 March 2014

| | Paragon Mortgages | Idem Capital | Paragon Bank | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| Interest receivable | 119.2 | 24.7 | - | 143.9 |
| Interest payable | (55.0) | (1.9) | - | (56.9) |
| Net interest income | 64.2 | 22.8 | - | 87.0 |
| Other operating income | 4.0 | 5.4 | - | 9.4 |
| Total operating income | 68.2 | 28.2 | - | 96.4 |
| Operating expenses | (20.9) | (7.0) | (3.1) | (31.0) |
| Provisions for losses | (7.5) | - | - | (7.5) |
| | 39.8 | 21.2 | (3.1) | 57.9 |
| Fair value net (loss) / gain | 0.3 | - | - | 0.3 |
| Operating profit / (loss) | 40.1 | 21.2 | (3.1) | 58.2 |
| Tax charge | | | | (12.6) |
| Profit after taxation | | | | 45.6 |

### Year ended 30 September 2014

| | Paragon Mortgages | Idem Capital | Paragon Bank | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| Interest receivable | 241.9 | 60.4 | 0.1 | 302.4 |
| Interest payable | (115.3) | (7.5) | (0.2) | (123.0) |
| Net interest income | 126.6 | 52.9 | (0.1) | 179.4 |
| Other operating income | 7.5 | 11.0 | - | 18.5 |
| Total operating income | 134.1 | 63.9 | (0.1) | 197.9 |
| Operating expenses | (41.3) | (15.8) | (6.3) | (63.4) |
| Provisions for losses | (12.3) | - | - | (12.3) |
| | 80.5 | 48.1 | (6.4) | 122.2 |
| Fair value net (loss) / gain | 0.6 | - | - | 0.6 |
| Operating profit / (loss) | 81.1 | 48.1 | (6.4) | 122.8 |
| Tax charge | | | | (25.6) |
| Profit after taxation | | | | 97.2 |

The assets of the segments listed above are:

| | 31 Mar 2015 | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| Paragon Mortgages | **10,559.4** | 10,192.0 | 10,343.3 | 10,127.4 |
| Idem Capital | **429.3** | 434.4 | 445.8 | 200.9 |
| Paragon Bank | **209.1** | 12.7 | 106.0 | - |
| | **11,197.8** | 10,639.1 | 10,895.1 | 10,328.3 |

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## 6. OTHER OPERATING INCOME

| | 31 Mar 2015 | 31 Mar 2014 | 30 Sep 2014 |
|---|---|---|---|
| | £m | £m | £m |
| Loan account fee income | **3.1** | 2.2 | 4.9 |
| Insurance income | **0.5** | 1.3 | 2.0 |
| Third party servicing | **2.6** | 5.5 | 10.8 |
| Other income | **0.6** | 0.4 | 0.8 |
| | **6.8** | 9.4 | 18.5 |

## 7. COST:INCOME RATIO

Cost:income ratio is derived as follows:

| | 31 Mar 2015 | 31 Mar 2014 | 30 Sep 2014 |
|---|---|---|---|
| Operating expenses (£m) | **36.6** | 31.0 | 63.4 |
| Total operating income (£m) | **104.0** | 96.4 | 197.9 |
| Cost ÷ Income | **35.2%** | 32.2% | 32.0% |

Cost:income ratio excluding Paragon Bank is derived as follows:

| | 31 Mar 2015 | 31 Mar 2014 | 30 Sep 2014 |
|---|---|---|---|
| Operating expenses (£m) | **36.6** | 31.0 | 63.4 |
| Paragon Bank operating expenses (£m) (note 5) | **(4.5)** | (3.1) | (6.3) |
| | **32.1** | 27.9 | 57.1 |
| Total operating income (£m) | **104.0** | 96.4 | 197.9 |
| Paragon Bank operating income (£m) (note 5) | **(0.1)** | - | 0.1 |
| | **103.9** | 96.4 | 198.0 |
| Cost ÷ Income | **30.9%** | 28.9% | 28.8% |

## 8. FAIR VALUE NET (LOSSES ) / GAINS

The fair value net (loss) / gain represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis generated by the requirements of IAS 39. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The losses are primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities. Such differences will reverse over time and have no impact on the cash flows of the Group.

## 9. UNDERLYING PROFIT

Underlying profit is determined by excluding from the operating result fair value accounting adjustments arising from the Group's hedging arrangements.

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
|---|---|---|---|
| | **£m** | £m | £m |
| **Paragon Mortgages** | | | |
| Profit before tax for the period (note 5) | **43.5** | 40.1 | 81.1 |
| Exclude: Fair value losses / (gains) | **1.2** | (0.3) | (0.6) |
| | **44.7** | 39.8 | 80.5 |
| **Idem Capital** | | | |
| Profit before tax for the period (note 5) | **23.6** | 21.2 | 48.1 |
| Exclude: Fair value losses / (gains) | **-** | - | - |
| | **23.6** | 21.2 | 48.1 |
| **Paragon Bank** | | | |
| (Loss) before tax for the period (note 5) | **(4.5)** | (3.1) | (6.4) |
| Exclude: Fair value losses / (gains) | **0.1** | - | - |
| | **(4.4)** | (3.1) | (6.4) |
| **Total** | | | |
| Profit before tax for the period | **62.6** | 58.2 | 122.8 |
| Exclude: Fair value losses / (gains) | **1.3** | (0.3) | (0.6) |
| Underlying profit before tax | **63.9** | 57.9 | 122.2 |

## 10. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

Income tax for the six months ended 31 March 2015 is charged at 20.4% (six months ended 31 March 2014: 21.6%, year ended 30 September 2014: 20.8%), representing the best estimate of the annual effective rate of income tax expected for the full year, applied to the pre-tax income of the period.

## 11. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 |
|---|---|---|---|
| Profit for the period (£m) | **49.8** | 45.6 | 97.2 |
| Basic weighted average number of ordinary shares ranking for dividend during the period (million) | **304.9** | 304.0 | 304.6 |
| Dilutive effect of the weighted average number of share options and incentive plans in issue during the period (million) | **7.1** | 8.2 | 7.6 |
| Diluted weighted average number of ordinary shares ranking for dividend during the period (million) | **312.0** | 312.2 | 312.2 |
| Earnings per ordinary share | | | |
| - basic | **16.3p** | 15.0p | 31.9p |
| - diluted | **16.0p** | 14.6p | 31.1p |

## 12. INTANGIBLE ASSETS

Intangible assets at net book value comprise:

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | **£m** | £m | £m | £m |
| Goodwill | **1.6** | 1.6 | 1.6 | 1.6 |
| Computer software | **1.3** | 1.3 | 1.3 | 1.4 |
| Other intangibles | **4.7** | 5.3 | 5.0 | 5.5 |
| Total assets | **7.6** | 8.2 | 7.9 | 8.5 |

## 13. FINANCIAL ASSETS

| | *Note* | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|---|
| | | **£m** | £m | £m | £m |
| Loans to customers | | **9,468.3** | 9,105.9 | 9,255.9 | 8,801.5 |
| Fair value adjustments from portfolio hedging | | **3.3** | (0.1) | 0.5 | - |
| Investments in structured entities | | **17.7** | 20.6 | 19.3 | 23.8 |
| Derivative financial assets | *14* | **810.9** | 757.7 | 693.9 | 890.0 |
| Total assets | | **10,300.2** | 9,884.1 | 9,969.6 | 9,715.3 |

The Group calculates its headline arrears measure for buy-to-let mortgages based on the numbers of accounts three months or more in arrears, including purchased Idem assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by the CML in compiling its statistics for the buy-to-let mortgage market as a whole.

The Group's loans to customers and investments in structured entities at 31 March 2015, analysed between the segments described in note 5, were as follows:

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | **£m** | £m | £m | £m |
| **Paragon Mortgages** | | | | |
| First mortgage loans | **8,802.8** | 8,480.8 | 8,635.2 | 8,384.3 |
| Consumer loans | **190.7** | 226.8 | 207.7 | 247.3 |
| Loans to customers | **8,993.5** | 8,707.6 | 8,842.9 | 8,631.6 |
| Investments in structured entities | **-** | - | - | - |
| Total investment in loans | **8,993.5** | 8,707.6 | 8,842.9 | 8,631.6 |
| | | | | |
| **Idem Capital** | | | | |
| First mortgage loans | **15.3** | 16.8 | 16.0 | 17.5 |
| Consumer loans | **373.9** | 381.2 | 391.2 | 152.4 |
| Loans to customers | **389.2** | 398.0 | 407.2 | 169.9 |
| Investments in structured entities | **17.7** | 20.6 | 19.3 | 23.8 |
| Total investment in loans | **406.9** | 418.6 | 426.5 | 193.7 |
| | | | | |
| **Paragon Bank** | | | | |
| First mortgage loans | **62.1** | - | 0.5 | - |
| Consumer loans | **23.5** | 0.3 | 5.3 | - |
| Loans to customers | **85.6** | 0.3 | 5.8 | - |
| Investments in structured entities | **-** | - | - | - |
| Total investment in loans | **85.6** | 0.3 | 5.8 | - |
| | | | | |
| **Total** | | | | |
| First mortgage loans | **8,880.2** | 8,497.6 | 8,651.7 | 8,401.8 |
| Consumer loans | **588.1** | 608.3 | 604.2 | 399.7 |
| Loans to customers | **9,468.3** | 9,105.9 | 9,255.9 | 8,801.5 |
| Investments in structured entities | **17.7** | 20.6 | 19.3 | 23.8 |
| | | | | |
| Total investment in loans | **9,486.0** | 9,126.5 | 9,275.2 | 8,825.3 |

In the debt purchase industry, Estimated Remaining Collections ('ERC') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios, but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IAS 39 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERC values for the Group's purchased assets are set out below, analysed by the balance sheet line on which they appear. These are derived from the same models and assumptions used in the effective interest rate calculations.



| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | **£m** | £m | £m | £m |
| **Carrying value** | | | | |
| Loans to customers | **389.2** | 398.0 | 407.2 | 169.9 |
| Investments in structured entities | **17.7** | 20.6 | 19.3 | 23.8 |
| | **406.9** | 418.6 | 426.5 | 193.7 |
| **84 month ERC** | | | | |
| Loans to customers | **521.7** | 559.2 | 554.8 | 272.6 |
| Investments in structured entities | **24.9** | 29.1 | 26.6 | 31.7 |
| | **546.6** | 588.3 | 581.4 | 304.3 |
| **120 month ERC** | | | | |
| Loans to customers | **609.3** | 669.2 | 649.9 | 313.3 |
| Investments in structured entities | **29.9** | 36.4 | 32.3 | 40.6 |
| | **639.2** | 705.6 | 682.2 | 353.9 |

## 14. DERIVATIVE FINANCIAL ASSETS AND LIABILITES

| | *Note* | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|---|
| | | **£m** | £m | £m | £m |
| Derivative financial assets | *13* | **810.9** | 757.7 | 693.9 | 890.0 |
| Derivative financial liabilities | *21* | **(5.0)** | (0.7) | (1.1) | (1.3) |
| | | **805.9** | 757.0 | 692.8 | 888.7 |
| Of which: | | | | | |
| Foreign exchange basis swaps | | **810.6** | 757.4 | 693.5 | 889.6 |
| Other derivatives | | **(4.7)** | (0.4) | (0.7) | (0.9) |
| | | **805.9** | 757.0 | 692.8 | 888.7 |

The Group's securitisation borrowings are denominated in sterling, euros and US dollars. All currency borrowings are swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with both euro and US dollar swaps, although the debit balance is compensated for by retranslating the borrowings at the current exchange rate.

## 15. SHORT TERM INVESTMENTS

This amount represents treasury bills and other liquid securities held as part of the liquidity requirement of Paragon Bank PLC. As such they are designated as 'Available for Sale', as defined by IAS 39 - 'Financial Instruments: Recognition and Measurement' and are consequently shown at market value.

## 16. CASH AND CASH EQUIVALENTS

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | **£m** | £m | £m | £m |
| Balances with central banks | **59.0** | - | - | - |
| Balances with other banks | **753.6** | 716.3 | 848.8 | 587.3 |
| | **812.6** | 716.3 | 848.8 | 587.3 |

Only 'Free Cash' is unrestrictedly available for the Group's general purposes. Cash received in respect of loan assets is not immediately available, due to the terms of the warehouse facilities and the securitisations. Cash held in the Group's banking subsidiary is subject to regulatory rules covering liquidity and capital adequacy, and is shown as 'Bank Cash' below.

'Cash and Cash Equivalents' also includes balances held by the Trustees of the Paragon Employee Share Ownership Plans which may only be used to invest in the shares of the Company, pursuant to the aims of those plans.

The total 'Cash and Cash Equivalents' balance may be analysed as shown below:

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | **£m** | £m | £m | £m |
| Free cash | **206.7** | 169.4 | 177.3 | 170.8 |
| Securitisation cash | **531.3** | 532.6 | 609.0 | 414.1 |
| Bank cash | **72.7** | 11.9 | 60.6 | - |
| ESOP cash | **1.9** | 2.4 | 1.9 | 2.4 |
| | **812.6** | 716.3 | 848.8 | 587.3 |

## 17. CALLED-UP SHARE CAPITAL

Movements in the issued share capital in the period were:

| | **Six months to 31 Mar 2015 Number** | Six months to 31 Mar 2014 Number | Year to 30 Sep 2014 Number |
|---|---|---|---|
| **Ordinary shares of £1 each** | | | |
| At 1 October 2014 | **307,308,283** | 306,213,215 | 306,213,215 |
| Shares issued | **1,637,402** | 895,068 | 1,095,068 |
| At 31 March 2015 | **308,945,685** | 307,108,283 | 307,308,283 |

During the period the Company issued 800,000 shares at par (six months ended 31 March 2014: 860,000; year ended 30 September 2014: 1,060,000) to the trustees of its ESOP Trusts in order that they could fulfil their obligations under the Group's share based award arrangements. It also issued 837,402 shares (six months ended 31 March 2014: 35,068; year ended 30 September 2014: 35,068) to satisfy options granted under sharesave schemes for a consideration of £1,193,801 (six months ended 31 March 2014: £36,884; year ended 30 September 2014: £36,884).

## 18. RESERVES

| | **31 Mar 2015 £m** | 31 Mar 2014 £m | 30 Sep 2014 £m | 30 Sep 2013 £m |
|---|---|---|---|---|
| Share premium account | **64.5** | 64.1 | 64.1 | 64.1 |
| Merger reserve | **(70.2)** | (70.2) | (70.2) | (70.2) |
| Cash flow hedging reserve | **(1.4)** | 1.2 | 0.6 | 1.7 |
| Profit and loss account | **716.1** | 654.4 | 693.5 | 619.1 |
| | **709.0** | 649.5 | 688.0 | 614.7 |

## 19. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the period:

| | **31 Mar 2015 £m** | 31 Mar 2014 £m | 30 Sep 2014 £m |
|---|---|---|---|
| Final dividend for the year ended 30 September 2014 of 6.0p per share | **18.3** | - | - |
| Final dividend for the year ended 30 September 2013 of 4.8p per share | **-** | 14.6 | 14.6 |
| Interim dividend for the year ended 30 September 2014 of 3.0p per share | **-** | - | 9.1 |
| | **18.3** | 14.6 | 23.7 |

An interim dividend of 3.6p per share is proposed (2014: 3.0p per share), payable on 24 July 2015 with a record date of 3 July 2015. The amount expected to be absorbed by this dividend, based on the number of shares in issue at the balance sheet date is £10.9m (2014: £9.1m). The interim dividend will be recognised in the accounts when it is paid.

## 20. OWN SHARES

| | 31 Mar 2015 £m | 31 Mar 2014 £m | 30 Sep 2014 £m |
|---|---|---|---|
| **Treasury shares** | | | |
| At 1 October 2014 | **39.5** | 39.5 | 39.5 |
| Shares purchased | **17.2** | - | - |
| At 31 March 2015 | **56.7** | 39.5 | 39.5 |
| | | | |
| **ESOP shares** | | | |
| At 1 October 2014 | **8.7** | 8.1 | 8.1 |
| Shares purchased | **5.1** | - | 1.4 |
| Shares subscribed for | **0.8** | 0.9 | 1.1 |
| Options exercised | **(5.9)** | (1.8) | (1.9) |
| At 31 March 2015 | **8.7** | 7.2 | 8.7 |
| Total at 31 March 2015 | **65.4** | 46.7 | 48.2 |
| Total at 1 October 2014 | **48.2** | 47.6 | 47.6 |
| | | | |
| **Number of shares held** | | | |
| Treasury | **4,763,900** | 668,900 | 668,900 |
| ESOP | **879,075** | 1,004,876 | 1,487,013 |
| Balance at 31 March 2015 | **5,642,975** | 1,673,776 | 2,155,913 |

## 21. FINANCIAL LIABILITIES

| | *Note* | 31 Mar 2015 £m | 31 Mar 2014 £m | 30 Sep 2014 £m | 30 Sep 2013 £m |
|---|---|---|---|---|---|
| **Current liabilities** | | | | | |
| Finance lease liability | | **-** | - | - | 1.6 |
| Retail deposits | *22* | **101.1** | - | 53.3 | - |
| Bank loans and overdrafts | | **0.2** | 1.0 | 1.1 | 1.4 |
| | | **101.3** | 1.0 | 54.4 | 3.0 |
| | | | | | |
| **Non-current liabilities** | | | | | |
| Asset backed loan notes | | **8,461.7** | 8,071.5 | 8,115.0 | 7,893.2 |
| Corporate bond | | **110.0** | 110.0 | 110.0 | 110.0 |
| Retail bonds | | **183.2** | 183.1 | 183.2 | 59.1 |
| Finance lease liability | | **-** | - | - | 8.6 |
| Retail deposits | *22* | **63.9** | - | 6.8 | - |
| Bank loans and overdrafts | | **1,237.7** | 1,294.3 | 1,397.9 | 1,311.2 |
| Derivative financial liabilities | *14* | **5.0** | 0.7 | 1.1 | 1.3 |
| | | **10,061.5** | 9,659.6 | 9,814.0 | 9,383.4 |

Details of changes in the Group's borrowings since the year end are given in note 23 below.

## 22. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the United Kingdom and are denominated in sterling. The deposits comprise principally term deposits and 120 day notice accounts. The method of interest calculation on these deposits is analysed as follows:

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | **£m** | £m | £m | £m |
| Fixed rate | **116.1** | - | 39.8 | - |
| Variable rates | **48.9** | - | 20.3 | - |
| | **165.0** | - | 60.1 | - |

The weighted average interest rate on retail deposits, analysed by charging method, was:

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | **%** | % | % | % |
| Fixed rate | **2.08** | - | 1.90 | - |
| Variable rates | **1.70** | - | 1.85 | - |

The contractual maturity of these deposits is analysed below.

| | **31 Mar 2015** | 31 Mar 2014 | 30 Sep 2014 | 30 Sep 2013 |
|---|---|---|---|---|
| | **£m** | £m | £m | £m |
| **Amounts repayable** | | | | |
| In less than three months | **1.9** | - | - | - |
| In more than three months but not more than one year | **98.4** | - | 52.8 | - |
| In more than one year, but not more than two years | **31.0** | - | 6.8 | - |
| In more than two years, but not more than five years | **32.9** | - | - | - |
| **Total term deposits** | **164.2** | - | 59.6 | - |
| **Repayable on demand** | **0.8** | - | 0.5 | - |
| | **165.0** | - | 60.1 | - |
| Total falling due in less than one year | **101.1** | - | 53.3 | - |
| Total falling due in more than one year | **63.9** | - | 6.8 | - |
| | **165.0** | - | 60.1 | - |

## 23. BORROWINGS

All borrowings described in the Group Accounts for the year ended 30 September 2014 remained in place throughout the period.

On 13 November 2014, a Group company, Paragon Mortgages (No. 21) PLC, issued £243.7m of sterling mortgage backed floating rate notes to external investors at par. £217.9m of the notes were class A notes, rated AAA by Standard and Poor's and Aaa by Moody's, £17.7m were class B notes, rated AA by Standard and Poor's and Aa2 by Moody's and £8.1m were class C notes rated A by Standard and Poor's and A1 by Moody's. The interest margins above LIBOR on the notes were 0.80% on the A notes, 1.40% on the B notes and 1.75% on the C notes, an average of 0.88% and the proceeds were used to pay down existing warehouse debt. The Group retained £6.3m of D notes and also invested £6.2m in the first loss fund, bringing its total investment to £12.5m, or 5.0% of the issued notes.

On 25 March 2015, a Group company, Paragon Mortgages (No. 22) PLC, issued €164.0m of euro mortgage backed floating rate notes and £175.7m of sterling mortgage backed floating rate notes to external investors at par. The euro notes were class A1 notes, rated AAA by Fitch and Aaa by Moody's and bearing interest at 0.5% above EURIBOR. £151.7m of the sterling notes were class A2 notes, rated AAA by Fitch and Aaa by Moody's, £12.0m were class B notes, rated AA by Fitch and Aa2 by Moody's and £12.0m were class C notes rated A+ by Fitch and A1 by Moody's. The interest margins above LIBOR on the sterling notes were 0.80% on the A2 notes, 1.35% on the B notes and 1.65% on the C notes. Cross-currency basis swaps were entered into at the time of the transaction; effectively translating the euro notes into a LIBOR linked sterling liability. This structuring is similar to that used in pre-credit crisis transactions which included euro notes and mitigates the currency risk inherent in the euro borrowings. The average interest margin on the transaction, taking swap costs into account was 0.95% and the proceeds were used to pay down existing warehouse debt. The Group retained £7.5m of class E notes and also invested £7.5m in the first loss fund, bringing its total investment to £15.0m, or 5.0% of the issued notes.

As with the Group's existing securitisation borrowings, these financings are structured so that payments of interest and principal are limited to cash generated from the funded assets and there is no recourse to other Group funds. Therefore the issue of these new borrowings do not impact on the liquidity risk of the Group.

During the year ended 30 September 2014 the facility provided by Macquarie Bank plc to Paragon Fourth Funding was renewed on substantially the same terms with a reduced margin of 1.750% above LIBOR, with effect from 12 December 2014 for a further two year period, and on 8 May 2015, after the period end the facility was increased from £250.0m to £300.0m.

Following the period end on 15 May 2015 the facility provided by Lloyds Bank to Paragon Fifth Funding was increased from £200.0m to £350.0m on its existing terms. Together these bring the Group's warehouse capacity to £750.0m.

On 11 February 2013 the Company inaugurated a £1,000.0m Euro Medium Term Note Programme under which it may issue retail bonds, or other notes, within a twelve month period. The prospectus was updated, renewing the programme for a further twelve month period on 23 October 2014.

Repayments made in respect of the Group's borrowings are shown in note 27.

## 24. RETIREMENT BENEFIT OBLIGATIONS

The defined benefit obligation at 31 March 2015 has been calculated on a year-to-date basis, using the latest actuarial valuation for IAS 19 purposes at 30 September 2014. There have been movements in financial market conditions since that date, requiring an adjustment to the actuarial assumptions underlying the calculation of the defined benefit obligation at 31 March 2015. In particular, over the period since the 30 September 2014 actuarial valuation, the discount rate has decreased by 0.7% per annum, whereas expectations of long term inflation have decreased by 0.2% per annum. The net effect of these changes has resulted in an increase in the value of the defined benefit obligation at 31 March 2015. The impact of the change in actuarial assumptions has been recognised as an actuarial loss in other comprehensive income.

The defined benefit plan assets have been updated to reflect their market value at 31 March 2015. In particular, over the period since 30 September 2014 the Plan assets have achieved results in excess of the assumptions made at 30 September 2014. The difference between the expected and actual return on assets has been recognised as an actuarial gain in other comprehensive income.

## 25. NET CASH FLOW FROM OPERATING ACTIVITIES

| | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|
| | **£m** | £m | £m |
| Profit before tax | **62.6** | 58.2 | 122.8 |
| Non-cash items included in profit and other adjustments | | | |
| - Depreciation of property, plant and equipment | **0.8** | 0.9 | 1.6 |
| - Amortisation of intangible assets | **0.7** | 0.6 | 1.3 |
| - Foreign exchange movements on borrowings | **119.6** | (131.5) | (194.5) |
| - Other non-cash movements on borrowings | **2.3** | 1.9 | 4.9 |
| - Impairment losses on loans to customers | **3.5** | 7.5 | 12.3 |
| - Charge for share based remuneration | **2.6** | 1.6 | 3.2 |
| | | | |
| Net (increase) / decrease in operating assets | | | |
| - Loans to customers | **(214.3)** | (308.7) | (462.2) |
| - Derivative financial instruments | **(117.0)** | 132.3 | 196.1 |
| - Fair value of portfolio hedges | **(2.8)** | 0.1 | (0.5) |
| - Other receivables | **0.8** | (0.7) | 0.3 |
| | | | |
| Net (decrease) / increase in operating liabilities | | | |
| - Retail deposits | **104.8** | - | 60.1 |
| - Derivative financial instruments | **3.9** | (0.6) | (0.2) |
| - Other liabilities | **(4.0)** | (1.5) | 2.7 |
| | | | |
| Cash (utilised) by operations | **(36.5)** | (239.9) | (252.1) |
| Income taxes (paid) | **(11.0)** | (6.5) | (17.4) |
| | | | |
| **Net cash flow (utilised) by operating activities** | **(47.5)** | (246.4) | (269.5) |

## 26. NET CASH FLOW USED IN INVESTING ACTIVITIES

| | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|
| | **£m** | £m | £m |
| Purchases of property, plant and equipment | **(0.7)** | (24.9) | (25.1) |
| Purchases of intangible assets | **(0.4)** | (0.3) | (0.7) |
| Increase in short term investments | **(9.1)** | (0.5) | (39.4) |
| **Net cash (utilised) by investing activities** | **(10.2)** | (25.7) | (65.2) |

## 27. NET CASH FLOW FROM FINANCING ACTIVITIES

| | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|
| | **£m** | £m | £m |
| Shares issued | **1.2** | 0.1 | - |
| Dividends paid (note 19) | **(18.3)** | (14.6) | (23.7) |
| Issue of asset backed floating rate notes | **533.4** | 468.5 | 862.8 |
| Repayment of asset backed floating rate notes | **(308.7)** | (160.0) | (450.2) |
| Issue of retail bonds | **-** | 123.9 | 123.9 |
| Movement on bank facilities | **(162.9)** | (16.4) | 85.1 |
| Purchase of shares (note 20) | **(22.3)** | - | (1.4) |
| **Net cash generated by financing activities** | **22.4** | 401.5 | 596.5 |

## 28. RELATED PARTY TRANSACTIONS

In the six months ended 31 March 2015, the Group has continued the related party relationships described in note 62 on page 171 of the Annual Report and Accounts of the Group for the financial year ended 30 September 2014. Related party transactions in the period comprise the compensation of the Group's key management personnel, transactions with the Group Pension Plan and fees paid to a non-executive director in respect of his appointment as a director of the Corporate Trustee of the Group Pension Plan. There have been no changes in these relationships which could have a material effect on the financial position or performance of the Group in the period.

Save for the transactions referred to above, there have been no related party transactions in the six months ended 31 March 2015.

## 29. AVERAGE NET MARGIN

The average net interest margin is calculated as follows:

| | **Six months to 31 Mar 2015** | Six months to 31 Mar 2014 | Year to 30 Sep 2014 |
|---|---|---|---|
| | **£m** | £m | £m |
| Opening loans to customers | **9,255.9** | 8,801.5 | 8,801.5 |
| Closing loans to customers | **9,468.3** | 9,105.9 | 9,255.9 |
| Average loans to customers | **9,362.1** | 8,953.7 | 9,028.7 |
| | | | |
| Net interest | **97.2** | 87.0 | 179.4 |
| Annualised net interest margin | **2.09%** | 1.96% | 1.99% |
| | | | |
| Impairment provision | **3.5** | 7.5 | 12.3 |
| Impairment as a percentage of average loan balance (annualised) | **0.07%** | 0.16% | 0.14% |

# INDEPENDENT REVIEW REPORT

to The Paragon Group of Companies PLC

## INTRODUCTION

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2015 which comprises the income statement, the statement of comprehensive income, the balance sheet, the cash flow statement, the statement of movements in equity and related notes 1 to 29. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our review work, for this report, or for the conclusions we have formed.

## DIRECTORS' RESPONSIBILITIES

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting,' as adopted by the European Union.

## OUR RESPONSIBILITY

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

## SCOPE OF REVIEW

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.



## CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2015 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

**Deloitte LLP**
Chartered Accountants and Statutory Auditor
Birmingham, United Kingdom
19 May 2015

# PRINCIPAL RISKS AND UNCERTAINTIES



There are a number of potential risks and uncertainties which could have a material impact on the Group's performance over the remaining six months of the financial year and could cause actual results to differ materially from expected and historical results. In the opinion of the directors these risks have not changed materially from those described in section A2.2 of the last annual report and accounts of the Company for the year ended 30 September 2014. These risks are summarised below.

## BUSINESS RISK

***The risk that UK economic conditions impact on the Group***

Deterioration in the general economy of the UK, where all of the Group's operations are situated, might adversely affect all aspects of the Group's business.

***The risk that the Group is unable to procure new assets***

The UK financial services market is highly competitive and the Group faces strong competition in all of the core markets in which it operates, including its lending markets and the debt purchase and asset servicing markets.

## CREDIT RISK

***The risk that the Group's loan assets will not be realised in cash***

As a primary lender the Group faces credit risk as an inherent component of its lending and asset purchase activities. Adverse changes in the credit quality of the Group's borrowers or arising from systematic risks in UK and global financial systems could reduce the recoverability and value of the Group's assets.

## LIQUIDITY RISK

***The risk that the Group will not be able to finance its future plans***

The Group relies on its access to sources of funding to finance the origination of new business, portfolio acquisitions and working capital.

## MARKET RISK

***The risk that net income from loan assets will be reduced***

Changes in interest rates may adversely affect the Group's net income and profitability. In particular the Group's profitability is determined by the difference between the rates at which it lends and those at which it can borrow. Therefore any changes in market interest rates which result in a mismatch can impact the Group's profit.

## CONDUCT RISK

***The risk that inappropriate or poor customer treatment could lead to customer detriment***

The Group provides a range of financial services products across several brands to consumers and small business customers. As a result, the Group is exposed to potential conduct risk should it fail to treat its customers fairly.

## OPERATIONAL RISK

***The risk that regulation or legal changes will increase the cost or reduce the scope of the Group's activities***

The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains much of its funding, have been subject to legislative and other intervention by UK Government, European Union and other regulatory bodies. Certain of the Group's own activities are also subject to direct regulation.

***The risk that the Group's systems will be unable to support its operational needs***

The activities of the Group subject it to operational risks relating to its ability to implement and maintain effective systems to process the high volume of transactions with customers.

***The risk that the Group will not have the required staff to execute its plans***

The success of the Group is dependent on recruiting and retaining skilled senior management and personnel at all levels of the organisation.

# CONTACTS

| | |
|---|---|
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| **Auditors** | Deloitte LLP<br>Four Brindleyplace<br>Birmingham B1 2HZ |
| **Solicitors** | Slaughter and May<br>One Bunhill Row<br>London EC1Y 8YY |
| **Registrars** | Computershare Investor Services PLC<br>The Pavilions<br>Bridgwater Road<br>Bristol BS99 6ZZ<br>Telephone: 0870 707 1244 |
| **Brokers** | Jefferies Hoare Govett<br>Vintners Place<br>68 Upper Thames Street<br>London EC4V 3BJ<br><br>UBS Limited<br>1 Finsbury Avenue<br>London EC2M 2PP |
| **Remuneration consultants** | New Bridge Street<br>10 Devonshire Square<br>London EC2M 4YP |
| **Consulting actuaries** | Mercer Limited<br>Four Brindleyplace<br>Birmingham B1 2JQ |

paragon

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